

Ethics Assignment Case Studies

The following are the case study scenarios for your Ethics Assignment. Each of you will be responsible for **one (1)** of these cases.

Case 1: Sam

Rick was hired as Controller to help sort out and organize the records of a \$7 million dollar medical supply firm. This company was recently extended a \$1,000,000 small business loan to acquire the assets of a competitor that was going out of business. In Rick's view, the acquisition was a financial mess. Inventory records were misplaced or inaccurate, and no one could figure out the accounts receivable, most of which were over 45 days past due. Although salesman from the acquired firm were retained, a sales decline in the industry and poor management of the new firm led to attrition of the best and brightest individuals.

Because of the sales decline, the bank was pressing to know more about the consolidated entity's current financial situation. Monica, the bank Vice President in charge of the loan, and her staff of bank auditors were in daily contact with Rick. Each morning, Rick was a bit nervous about that days' cash draw since the firm really played the float. Moreover, Russ, the President, would often hold large vendor checks in his desk drawer without telling Rick.

Although the financial resources were strained at best (the firm had trouble reimbursing petty cash), there was a sense of optimism within the organization. As the company penetrated the nursing home industry, it was pulling in enormous profits from Medicare due to mark-ups at eight times its costs. As a result of these sales, the firm would start earning a small profit in the fourth quarter. Even at the end of the year, however, Russ did not want to mention these sales figures to the bank or accrue the revenue and accounts receivable until the checks arrived, because he was unsure when the government would be paying for the goods, and more importantly, because he wanted to have something in his back pocket in case the bank wanted to foreclose. Furthermore, Russ, as the majority stockholder in the firm, was concerned he would lose the firm if bankruptcy proceedings should start.

After a few months of recording sales on a cash basis, Rick started slipping hints to the bank that the company's financial status was better than was reported. Still, it was not his company, and he needed to keep his job. He knew that Russ would "play games" with other people, but he would not appreciate other people's "playing games with him." Moreover, Russ did not trust new employees, and Rick knew he would have to "earn" the President's trust.

Case 2: Nicole

Maria and Andy worked well together to organize the accounting system and records of a growing Health Maintenance Organization (HMO). Bob and Connie, the two top executives in the HMO, were tightly focused on company growth as it related to monthly and yearly revenue. Bob was also in charge of budget reports.

Every month Maria and Andy would compile financial statements which were reviewed by company officers and later reported in patient and employee newsletters. Oftentimes sales would fall below Bob's original projections. At such times, Bob would rant and rave about the low patient revenue accruals and comment "that surely more must be accrued." Andy and Maria would often remark to each other "why don't we just book the budget," since that is essentially what they did every month after their initial financial figures were reviewed, at least in terms of sales.

Although Andy and Maria realized that at year-end the auditors would not condone Bob's recording practices, they were still somewhat angry that "their" precise accounting system required monthly adjustments because of Bob and Connie's need to "look good to the board."

Of course, when year-end came, the glowing financial news fell short of projections. Although the shortfall was not enough to raise the HMO rates, it did send a panic through the accounting department. This information was not reported directly to shareholders, but it was embarrassing to make the year-end adjustments while scrambling to uncover additional revenues; and explain to coworkers why monthly newsletters were incorrect.

Case 3: Owen

In addition to the usual mix of compilation, review and audit clients for which Heather Hunt serves as a senior in a small office of a regional CPA firm, she has been assigned a new client that recently engaged the firm. Fashion First, an incorporated retail outlet, is a thriving local store. The business is run by a single owner/manager, "Buzz" Thompson, who makes all major decisions. The business has not previously used the services of a CPA firm. In addition to preparation of financial statements, the CPA firm will handle tax returns for the business.

At her first visit to the client's office, Heather is introduced to Sandy, the part-time bookkeeper who is also a full-time accounting student at the local university. At a subsequent meeting, Sandy confides to Heather that she found the job at the beginning of the semester after an extensive search. Sandy really needs the money to help finance her education, and feels lucky to have found a good-paying job during the current economic downturn. Feeling that Heather is someone she can talk to and get advice from, Sandy describes a situation that has been on her mind for some time now.

Sandy's concern relates to the handling of sales revenues. When monies from sales revenues are counted and deposited on a weekly basis, a chart is filled out with categories carefully delineating the type of payment: cash, checks, American Express, or Visa/Mastercard. Sandy's employer, after depositing the weekly total, brings this chart back with his own written-in total of the actual amount deposited.

After looking over some of these weekly deposit charts, Sandy noticed that \$500 cash was missing from each deposit. After a more thorough inspection of monthly tax documents that "Buzz" Thompson has filled out, Sandy noticed that the reported monthly gross revenue was \$2,000 less than what had been actually counted.

The employer is the only person handling the money after it has been counted. He is also the only one to deposit the money. When Sandy asked Mr. Thompson about revenue not being reported for tax purposes, he assured her that every dollar of income was reported on the tax forms. Furthermore, "Buzz" asserted, since Sandy wasn't the person who signed the forms, she shouldn't be concerned.

Case 4: Kaidem

Kelsey, a senior accountant at a multi-office CPA firm, is assigned to the audit of Compo Corporation. Compo is a closely held corporation and a major client of the firm. During the audit, Kelsey finds a material cut off error which causes Compo's income to be significantly misstated. Kelsey is aware that the CPA firm's policy clearly states the audit senior must document any potential material adjustment in the work papers. The final determination of materiality is then made by the partner in charge of the audit. Kelsey also knows Compo does not want to make the adjustment.

Before wrapping up the field work, the audit manager, Bruce, tells Kelsey, "Let's not mention this adjustment in the work papers. Since Compo is closely held and there are not tax implications, the partner has decided not to force an adjustment. Compo is our largest client. We need to get the Compo work up to the partner as soon as possible."

Kelsey is concerned and upset after the conversation with Bruce. Failure to document such a material amount just does not seem right.

Case 5: Conrad

Penny is the first Controller ever hired at a medium-sized farm machinery company. The firm has reacquired tractors and other parts and equipment from farmers who filed for bankruptcy or were seriously behind in their monthly payments during a recent two-year downturn in the economy. In addition, the firm has acquired some miscellaneous inventory from competitors experiencing the same misfortune.

One of Penny's initial goals is to determine how accurately the inventory on the books reflects its fair market value. As she walks with Ron, the inventory control clerk, through all the equipment and inventory pallets, she notices that numerous parts and machines look rusty and dusty. Ron informs her that while only about a third of these items are repossessions, most are from overruns or the recession; "many have been sitting on these skids for years." As Penny inquires further, it appears that this problem is extensive, and that this inventory moves slowly. When the inventory does sell, it is at a significant discount. Rhonda, the Sales Manager, indicates that these are really tough times to sell this stuff, especially because most of the "slow movers" are large-ticket items. In fact, Rhonda feels sorry for her sales staff since they have been forced by the company president to push these items with only 2 percent more in commission.

Finally, Penny approaches Art, the Company President, about this problem and asks what he intends for her to do about the dilemma. Art informs her that he believes that many of these items are saleable given appropriate marketing and the right economic conditions. Besides, some of his major customers owe him a few favours. Art also indicates that now is not the right time for the company to take a hit from inventory revaluation.

During the ensuing months, Penny did not see much movement from these stacks. She again approached Art and asked how he would address this issue when the audit came. Art reiterated his former response regarding product saleability and stressed actual sales across all product lines to the auditors. He asked Penny not to point out this problem to the auditors and finally said, "just see if they notice it. And if they start nosing around in it, I hope you'll be able to show them that some of these items are turning over." Penny interpreted Art as saying she should help falsify records if it looked like the auditors were discovering the slow movers. Penny didn't know what she would do next.

Case 6: Jack

Diana is a college graduate with accounting as her major and is planning to take the CPA exam. She recently accepted the Staff Accountant's position with the ZZ Cinema Franchise. There are 20 theatres that are owned by the Franchise in a widely spread geographic area.

John is manager of all the locations of the theatre franchise and William, distantly related to him, is the Assistant Manager working solely at his location. Jodi sells tickets from a glass cage and collects the cash from patrons. At the end of the last show, he adds up the cash receipts, reconciles his sales and hands over unsold tickets and cash to William. Bob, the doorman, collects the tickets from incoming patrons, tears the tickets into two, hands over one to the patron and drops the second half into a little locked box which William picks up at the end of the day. William prepares the bank deposit slip, deposits the cash in the bank, and keeps the bank receipts and the unsold tickets in the office safe to which he has the only key. William also prepares the bank reconciliation statements and submits weekly sales reports to Diana.

Of late, William has volunteered quite frequently to speed up ticket sales on crowded days by working Jodi's station at the sales counter. John has not objected to this practice. During the past month William has been seen driving a fancy new Lexus to work and seen dining with an attractive blond at the town's expensive restaurants. Diana finds from William's reports that sales have shown no change from previous weeks, even though there appears to be an obvious and significant increase in movie theatre attendance during the summer season. This puzzles Diana, who suspects this apparent discrepancy is being pocketed by William. More puzzling, why hasn't John also noticed this problem? Diana wonders if she should report her suspicions to someone in authority. After all, she has no proof. More importantly, should she go to John? He might be involved in this possible scam. What should she do?